

## Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:4

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Date: August 01, 2012

In Re:

### Legend:

Settlor	=
Child	=
Grandchild A	=
Grandchild B	=
Grandchild C	=
Corporate Fiduciary	=
Trust	=

Date	=
Year	=
State	=
State Statute	=

State Court	=
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### Grandchild Trusts

Grandchild A Trust	=
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Grandchild B Trust	=
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Grandchild C Trust	=
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Dear \_\_\_\_\_ :

This letter responds to your authorized representative's letter dated January 31, 2012, requesting rulings concerning the federal income, gift, estate, and generation-skipping transfer (GST) tax consequences of the proposed division and modification of a trust.

The facts submitted and representations made are as follows. Settlor created the Trust, an irrevocable trust, on Date (a date before September 25, 1985) for the benefit of Child's descendants. The Trust is administered under the laws of State. Settlor died in Year.

Item II(a) of the Trust provides that the trustees are authorized to pay out or use part or all of the trust income and principal to or for the benefit of Child's descendants at such times and in such amounts as the trustees in their sole judgment and discretion deem best to provide for the descendants' support, education, health, maintenance, comfort and well-being.

Under Item II(c) and (d), on Child's death, the property remaining in the trust is to be divided *per stirpes* into trusts for Child's then living descendants. The trustees of each trust for a descendant of Child are authorized to pay out or use part or all of the income and principal of that trust to or for the benefit of that descendant, his or her descendants, and their respective spouses, at such times and in such amounts as the trustees in their sole judgment and discretion deem best to provide for their support, education, health, maintenance, comfort and well-being.

Item II(e) provides that when a descendant of Child for whose benefit a trust is established attains age twenty-five, one-half of that trust's property is to be distributed to him or her. When the descendant attains age thirty, all of that trust's property is to be distributed to him or her. If a descendant dies after a trust is set apart for him or her but before receiving all of that trust's property, that descendant's trust is to be distributed as that descendant directs in his or her will, except that he or she cannot appoint the property to himself or herself, his or her estate, his or her creditors, or the creditors of his or her estate. If the descendant fails to direct any part of his or her trust, then that part of the descendant's trust is to be distributed *per stirpes* among his or her then living descendants, if any, and, if none, *per stirpes* among the descendants of Settlor's descendant who is his or her nearest ancestor who has descendants then living.

At the present time, Child is living. Child has three children, Grandchild A, Grandchild B, and Grandchild C, each of whom has attained age 30. Corporate Fiduciary is the trustee of Trust. It is represented that no additions have been made to Trust after September 25, 1985.

Proposed transaction

The beneficiaries have different investment goals and financial situations. Accordingly, the trustee proposes to divide the Trust into three separate trusts, the Grandchild A Trust, Grandchild B Trust, and Grandchild C Trust. The division will be accomplished by a pro rata division of each asset of the Trust. The dispositive terms of each resulting separate trust will be identical to the dispositive terms of the Trust and to each other, except that the beneficiaries will be limited to the Grandchild or Grandchild's issue for whom the respective trust is set aside. Because each Grandchild has attained age 30, his or her separate trust will terminate on Child's death, and the principal of that Grandchild's trust will be distributed outright to that Grandchild or pursuant to that Grandchild's testamentary disposition. If the Grandchild fails to direct any part of his or her trust, then that part of that Grandchild's trust is to be distributed *per stirpes* among his or her then living descendants, if any, and, if none, *per stirpes* among the descendants of Settlor's descendant who is his or her nearest ancestor who has descendants then living.

The trustee filed a petition in the State Court, pursuant to State Statute, requesting an order modifying the Trust as described above. State Court has approved the division and issued an order to reform and divide the Trust accordingly. The order is subject to the Internal Revenue Service's approval of the transaction.

You have asked us to rule that the proposed division of Trust into three separate equal trusts and the pro rata allocation of each Trust asset to those trusts:

1. Will not cause the Trust or a resulting Grandchild Trust to lose its exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986, and will not cause a distribution from or termination of any interest in Trust or a Grandchild Trust to be subject to GST tax under § 2601 of the Internal Revenue Code.
2. Will not result in the realization by the Trust, a Grandchild Trust, or a beneficiary of such trusts of income, gain or loss under § 661, 61, or 1001.
3. Will result in each Grandchild Trust being treated as a separate trust under § 643(f).
4. Will result in each Grandchild Trust holding its share of Trust property with the same basis as when owned by the Trust at the time of the division under § 1015, and with a holding period for such property that includes the Trust's holding period under § 1223.
5. Will not cause any portion of the assets of the Trust or a Grandchild Trust to be includible in the gross estate of any beneficiary of the Trust or a Grandchild's

Trust under §§ 2036 through 2038.

6. Will not be a transfer by any beneficiary of the Trust or a Grandchild Trust subject to gift tax under § 2501.

### Ruling 1

Section 2601 imposes a tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the GST tax, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(i)(D)(2) provides that, for purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a

beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, considers a situation in which, in 1980, Grantor established an irrevocable trust for the benefit of his two children, *A* and *B*, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to *A*, *B*, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of *A* and *B*, the trust principal is to be distributed to the living issue of *A* and *B*, *per stirpes*. In 2002, the appropriate State Court approved the division of the trust into two equal trusts, one for the benefit of *A* and *A*'s issue and one for the benefit of *B* and *B*'s issue. The trust for *A* and *A*'s issue provides that the trustee has the discretion to distribute trust income and principal to *A* and *A*'s issue in such amounts as the trustee deems appropriate. On *A*'s death, the trust principal is to be distributed equally to *A*'s issue, *per stirpes*. If *A* dies with no living descendants, the principal will be added to the trust for *B* and *B*'s issue. The trust for *B* and *B*'s issue is identical (except for the beneficiaries), and terminates at *B*'s death at which time the trust principal is to be distributed equally to *B*'s issue, *per stirpes*. If *B* dies with no living descendants, principal will be added to the trust for *A* and *A*'s issue. The division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In the present case, the Trust was irrevocable on September 25, 1985. It is represented that no additions have been made after September 25, 1985.

The proposed division of the Trust into Grandchild A Trust, Grandchild B Trust and Grandchild C Trust is substantially similar to the situation described in Example 5 of § 26.2601-1(b)(4)(i)(E). Under the proposed division and modification, the Grandchild A Trust, Grandchild B Trust and Grandchild C Trust will be administered under the original terms of Trust.

Based on the facts submitted and the representations made, and provided the State Court order is effective under State law and includes the modifications as

described above, we conclude that the proposed division and modification of Trust will not shift a beneficial interest in Trust to any beneficiary who occupies a lower generation than the persons holding the beneficial interests prior to the division and modification. In addition, the proposed division and modification will not extend the time for vesting of any beneficial interest in the Grandchild Trusts beyond the period provided in the original terms of the Trust. Accordingly, the proposed division and modification will not cause Trust or any Grandchild Trust to lose its exempt status and will not cause any distribution from or termination of any interest in the Trust or a Grandchild Trust to be subject to GST tax under § 2601.

## Ruling 2

Section 61(a)(3) provides that gross income includes gain derived from dealings in property.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year.

Section 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

Section 1.661(a)-2(f) of the Income Tax Regulations provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property

for cash or for other property differing materially either in kind or in extent is treated as income or loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature and the partition of a joint tenancy in stock are not sales or exchanges. Similarly, divisions of trusts are also not sales or exchanges of trust interests where each asset is divided pro rata among the new trusts. See Rev. Rul. 69-486, 1969-2 C.B. 159 (pro rata distribution of trust assets not a sale or exchange).

The Trust assets will be distributed equally among each Grandchild Trust. Each Grandchild Trust will contain a proportionate share of the assets of the Trust equal to a respective beneficiary's beneficial interest in the Trust's assets. Accordingly, the modification and severance of the Trust will not result in the realization of gain or loss under §§ 61 and 1001. In addition, because the modification and severance of the Trust is not a taxable event under § 1001, the holding period of the assets that the Grandchild Trusts receive from the Trust will include the period that the Trust held those assets.

The transfer of assets from the Trust to the Grandchild Trusts will not be treated as a distribution or termination under § 661 and will not result in the realization by the Trust, a Grandchild Trust, or by any beneficiary of the Trust or a Grandchild Trust of any income, gain, or loss under § 662.

### Ruling 3

Section 643(f) provides that, for purposes of subchapter J of chapter 1 of subtitle A, under regulations prescribed by the Secretary, two or more trusts shall be treated as one trust if (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1.

Section 1806(b) of the Act provides that § 643(f) shall apply to taxable years beginning after March 1, 1984; except that, in the case of a trust which was irrevocable on March 1, 1984, it shall apply only to that portion of the trust which is attributable to contributions to corpus after March 1, 1984.

Based solely on the facts and representations submitted, we conclude that as long as each Grandchild Trust created by the division of the Trust is separately managed and administered, they will be treated as separate trusts for federal income tax purposes.

### Ruling 4:

Section 1015 generally provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss recognized.

Section 1.1015-1(b) provides that property acquired by gift has a single uniform basis although more than one person may acquire an interest in the property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by a transfer in trust (other than a transfer in trust by gift, bequest or devise), the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor under the law applicable to the year in which the transfer was made.

Section 1.1015-2(a)(2) provides that the principles in § 1.1015-1(b) concerning the uniform basis are applicable in determining basis of property where more than one person acquires an interest in property by transfer in trust.

Section 1223(2) provides that in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person, if the property has the same basis in whole or in part in the taxpayer's hands as it would have in the hands of the other person.

Here, since the division of the Trust is not a sale or other disposition of property, and the property has the same basis in the hands each Grandchild Trust as it would have had in the hands of the Trust, the holding period of the assets in the hands of the Grandchild Trusts will include the holding periods of the assets in the hands of the Trust pursuant to § 1223. Accordingly, under § 1223(2) the holding periods of the assets received by the Grandchild Trusts will include the holding periods of those assets in the Trust.

#### Ruling 5

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in



conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power) to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period on the date of the decedent's death.

In the present case, the distribution, management, and termination provisions of the Grandchild Trusts will be substantially similar to the current distribution, management, and termination provisions of the Trust. Accordingly, based on the facts submitted and the representations made, the division and modification of the Trust will not cause any property of the Trust or a Grandchild Trust to be includible in the gross estate of any beneficiary of any such trust under §§ 2036, 2037, or 2038.

#### Ruling 6

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511 provides that the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

In this case, the beneficiaries of the Grandchild A Trust, Grandchild B Trust and Grandchild C Trust will have the same interests after the division that they had as beneficiaries under the Trust. Because the beneficial interests, rights, and expectancies of the beneficiaries are substantially similar, both before and after the division, no transfer of property will be deemed to occur as a result of the division and modification.

Accordingly, based on the facts submitted and the representations made, we conclude that the division and modification of the Trust, as described above, will not constitute a transfer by any beneficiary of the Trust or a Grandchild Trust subject to federal gift tax under § 2501.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures  
Copy for section 6110 purposes  
Copy of this letter